

Missouri State Lottery Commission

A Component Unit of the State of Missouri

Comprehensive Annual Financial Report

For the Fiscal Year Ended June 30, 2005



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Prepared By
Finance and Administration Division

Missouri State Lottery Commission
A Component Unit of the State of Missouri

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Table of Contents

Introductory Section

Letter of Transmittal.....	1
Certificate of Achievement for Excellence in Financial Reporting.....	5
Organizational Chart and Principal Officials.....	6

Financial Section

Independent Auditor's Report.....	7
Management's Discussion and Analysis.....	8
Basic Financial Statements	
Statements of Net Assets.....	13
Statements of Revenues, Expenses and Changes in Net Assets.....	14
Statements of Cash Flows.....	15
Notes To Financial Statements.....	16

Statistical Section (Unaudited)

Statistics.....	23
Sales and Other Revenues for Fiscal Years 1996 through 2005.....	24
Expenses and Transfers to the State for Fiscal Years 1996 through 2005.....	24
Sales by Product for Fiscal Years 1996 through 2005.....	26
Sales by Fiscal Year by Product for Fiscal Years 1996 through 2005.....	27
Expenses and Transfers for Fiscal Years 1996 through 2005.....	28
Expenses and Transfers by Fiscal Year for Fiscal Years 1996 through 2005.....	29
Missouri Demographics.....	30
National Statistics.....	31

Supplementary Information

Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting.....	33
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Introductory Section





November 14, 2005

To: Barbara H. Pickering, Chairman Missouri State Lottery Commission
Charles Larry Ray, Member
Sherri Robins, Member
Celeste Witzel, Member
Larry P. Jansen, Executive Director
Citizens of the State of Missouri

Introduction

We are pleased to transmit this Comprehensive Annual Financial Report (CAFR) of the Missouri State Lottery Commission (MLC) for the year ended June 30, 2005. In this report we have included an introduction, our financial statements including the independent auditor's opinion on the financial statements, and statistical data relevant to the operations of the Lottery. The MLC is responsible for the accuracy and fairness of this presentation. The MLC is included as a component unit of the State of Missouri. This report presents the activity of the MLC as a single enterprise fund and does not include information related to any other state agency or fund. We trust that you will find this report informative as to the success of the Lottery as well as the challenges and opportunities that face the MLC in the future.

The Introductory Section of this report includes this transmittal letter and an organization chart denoting principal officials. The Financial Section includes the independent auditor's report and the comparative financial statements and accompanying notes. The Statistical Section contains other selected data relevant to the operations of the MLC. The final section includes a report on compliance and internal control.

Accounting principles generally accepted in the United States of America require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. The MLC's MD&A can be found immediately following the report of the independent auditors.

The MLC was created by the passage of a constitutional amendment on November 6, 1984 by the citizens of the State of Missouri. Ticket sales began January 20, 1986, with the introduction of a single scratch-off game, Jackpot 86. This represented the first legislatively authorized lottery tickets sold in Missouri since the New Franklin Railroad Lottery (later known as the Missouri State Lottery) was closed down in 1877.

The MLC is a Type III division assigned to the Missouri Department of Revenue as defined in Section 313.210 of the Missouri Revised Statutes. The Department of Revenue has no control, supervision, or authority over the actions or decisions of the MLC. The Commission consists of five members appointed by the Governor with the advice and consent of the Senate.

Products

The MLC currently offers the following games for players to choose from:

Scratcher Games are provided through a contract with Scientific Games Inc. that provides game design consultation, printing, and electronic validation information for prize payment. These games are played by scratching a latex coating to reveal the play area of the ticket. There are different ways to win including matching certain symbols, adding up to a specified total or otherwise satisfying the requirements listed on the ticket. These play styles are combined with a variety of game themes and price points. If the specified condition occurs the ticket is an instant winner. These games were the first offered by the MLC and continue to represent over 50% of our total annual ticket sales.

On-line games are provided through a contract with GTECH Corporation that maintains selling terminals at retail locations and a central processing system operated on a Lottery-owned telephone network and a vendor-owned

satellite system. These games are played by purchasing a ticket from a retailer through an on-line (computerized) selling terminal. These tickets are then held until a drawing is conducted by the MLC and witnessed by independent auditors to determine the winning numbers. Drawings are conducted twice a day or twice a week dependent upon the game. Pick 3, Pick 4, and Show Me 5 Paydown are drawn twice daily and are distinguished by their play styles, prize amounts, and odds of winning. In fiscal 2004, the MLC added a feature to the daily games, called Xtra, which was discontinued in July 2004 when the second daily drawings were added. Club Keno is an on-line game sold in age-controlled environments with drawings every 5 minutes. Players choose the number of “spots” they want to play that in turn determines the amount they may win. Missouri Lotto is drawn twice a week and offers a guaranteed minimum top prize of \$1 million paid over 25 years. The top prize grows for each draw that it is not won. Powerball is a lotto style game that, in fiscal 2005, offered a guaranteed minimum top prize of \$10 million paid over 30 years. On August 28, 2005, the guaranteed minimum top prize for Powerball was increased to \$15 million paid out over 30 years. The Powerball game is offered in conjunction with 28 other jurisdictions through the Multi-State Lottery Association. Profits for all on-line games sold in Missouri stay in Missouri.

Pull-Tabs are provided through a contract with American Games Inc. and are played by opening tabs on one side of the ticket to reveal rows of symbols under each tab. Prizes are won by matching symbols indicated on the front of the ticket. The retailer who sold the ticket pays most pull-tab prizes. The MLC has introduced pull-tab games with a top prize of \$1000 that must be paid by the MLC.

Economic Outlook

The MLC experienced a decrease in overall sales in fiscal 2005 after reaching record sales levels in fiscal 2004. The online games showed a decrease of 11% from the prior year. This is due primarily to the Powerball and Lotto games. The Powerball and Lotto game sales are driven by the size of the jackpot and jackpots in these games exceeded expectations in 2004. The addition of second drawings for each of the daily games, Pick 3, Pick 4, and Show Me 5 Paydown, helped to offset the overall decrease in online game sales with a cumulative increase of over 8% in sales. Scratch game sales increased by over 7% for 2005 due to an increase in the sales of higher price point games and the installation of 20-game scratcher ticket promoters in retail locations.

The economic outlook for the State of Missouri appears stable with projections for moderate growth over the next three years. However, looking at the history of lottery sales both in Missouri and throughout the lottery industry, there does not seem to be a correlation between the state of the economy and lottery sales.

A fairly stable economic environment, as well as maturity of traditional lottery products, decreasing promotional resources authorized by the appropriation process, competition from other forms of gambling, and additional demands on consumers’ discretionary funds should all contribute to a flat to moderate growth curve in product sales over the next twelve to eighteen months.

Accomplishments and Initiatives

- Twice daily drawings for Pick 3, Pick 4, and Show Me 5 Paydown
- Conversion to a new online gaming system
- Installation of 20-game scratcher ticket promoters in retail locations

Financial Information

Accounting System and Policies:

The MLC uses the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under the accrual basis of accounting revenues are recognized when earned and expenses are recognized at the time the related liabilities are incurred.

Budgetary Controls:

The MLC annually submits a request for appropriation through the budgetary process of the State of Missouri. Expenditures of the MLC are subject to this appropriation process. The MLC does use interest earnings at the Multi-State Lottery Association (MUSL) to offset certain administrative and promotional expenses. The balance of these MUSL interest earnings is transferred to the Lottery Proceeds Fund.

Expenses associated with the operation of the MLC are submitted for payment through the Missouri Office of Administration, Division of Accounting. The MLC maintains its own signature authority for payment of prizes through an imprest checking account. The MLC has its own purchasing authority and has adopted the same rules

and procedures as that of the Office of Administration, Division of Purchasing and Materials Management, with the exception of providing for preferences and exclusive solicitation for minority and women owned businesses.

Debt Administration:

Long-term liabilities for multi-year prizewinners are presented on the statement of net assets. The MLC holds US Treasury Strips in the name of prizewinners for the purpose of funding these payments. The MLC does own some insurance annuities to fund prizes won prior to August 1990.

Cash Management:

A portion of the MLC's funds are maintained by the Office of State Treasurer and as such are pooled in short term investments until needed for cash payments.

Risk Management:

The MLC's major assets including buildings, data processing and other major equipment are insured by a third party carrier maintained by the Office of Risk Management. The MLC also maintains business interruption insurance. Liability indemnity for operation of the Lottery is managed through the State's Legal Defense Fund of the Office of Attorney General.

Internal Control Environment

Management of the MLC is responsible for establishing and maintaining an internal control structure designed to ensure that assets are protected from loss, theft, or misappropriation. The internal control system is also designed to ensure that the accounting system provides accurate and timely financial information. The structure does not provide a guarantee but rather reasonable assurance that these objectives are met.

To enhance controls over accounting procedures, the MLC has segregated appropriate functions where feasible, and added additional administrative reviews of areas not clearly segregated to ensure compliance with established control policies.

Section 313.315 of the Missouri Revised Statutes requires the State Auditor to conduct a biennial audit of all accounts and transactions of the MLC, and such other special audits, as it may deem necessary. The MLC is also required to employ an independent firm of accountants to conduct an annual audit of all accounts and transactions of the MLC. This audit includes a review of internal controls as they relate to the expression of an opinion on the financial statements.

In addition, the MLC has from time to time employed the services of other qualified external firms to conduct reviews of our security procedures for data processing and controls with game operations.

Future Projects

Major initiatives in 2006 and beyond include:

- Offer a \$10 Scratcher game with a top prize level of \$1,000,000
- Undertake a strategic planning process
- Celebrate our 20th anniversary with a variety of promotional events and a new raffle-style game
- Evaluate our on-line terminal communication network

Government Finance Officers Association Certificate of Achievement

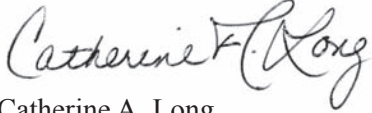
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Missouri State Lottery Commission for its comprehensive annual financial report for the fiscal year ended June 30, 2004. This was the fifth consecutive year that the Lottery has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgements

Preparation of this report could not have been accomplished without the entire accounting staff. This CAFR represents our ongoing commitment to provide financial systems and information in conformance with the highest standards of public accountability.

Respectfully submitted,

A handwritten signature in black ink, reading "Catherine A. Long". The signature is fluid and cursive, with the first name "Catherine" and last name "Long" clearly legible.

Catherine A. Long
Acting Chief Financial Officer
Missouri State Lottery Commission

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Missouri State Lottery

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



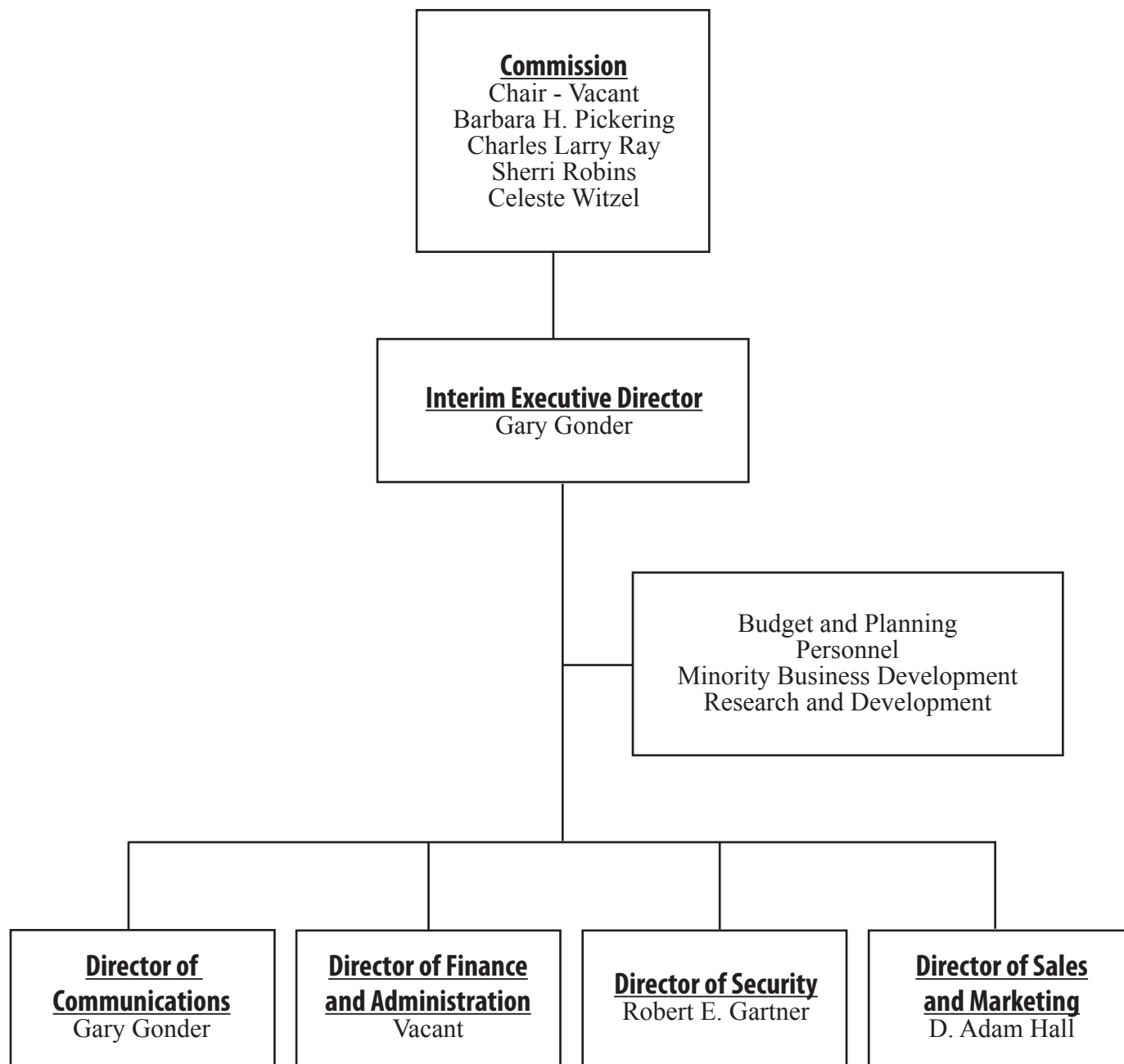
Nancy L. Ziehl

President

Jeffrey R. Enen

Executive Director

Missouri State Lottery Commission
Principal Officials and Organization Chart
June 30, 2005



Financial Section





Berberich Trahan & Co., P.A.
Certified Public Accountants
Topeka, Kansas 66611-2050



COCHRAN, HEAD & CO., P.C.
Certified Public Accountants
Liberty, Missouri 64068

INDEPENDENT AUDITORS' REPORT

To the Missouri State Lottery Commission:

We have audited the accompanying basic financial statements of the business-type activity of the Missouri State Lottery Commission (the Lottery), a component unit of the State of Missouri, as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These basic financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the business-type activity of the Missouri State Lottery Commission, as of June 30, 2005 and 2004, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 6, 2005 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 8 through 12 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements. The accompanying introductory section and statistical tables are presented for purposes of additional analysis and are not a required part of the basic financial statements. The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Berberich Trahan & Co., P.A.

Cochran, Head & Co., P.C.

Management's Discussion and Analysis for the Fiscal Years Ended June 30, 2005 and 2004

This discussion and analysis of the Lottery's financial performance provides an overview of the financial activities for the fiscal years ended June 30, 2005 and 2004. Please read it in conjunction with the Lottery's financial statements, which begin on page 13. These financial statements reflect only activities of the Missouri State Lottery Commission (MLC), a component unit of the State of Missouri.

Using This Annual Report

This annual report consists of a set of financial statements. The Statements of Net Assets provide information about the MLC assets and liabilities and reflect the MLC financial position as of June 30, 2005 and 2004. The Statements of Revenues, Expenses, and Changes in Fund Net Assets report the activity of selling lottery products and expenses related to such activity for the years ended June 30, 2005 and 2004. The Statements of Cash Flows outline the cash inflows and outflows related to the activity of selling lottery products for the years ended June 30, 2005 and 2004.

MLC Net Assets

	As of June 30, 2005	As of June 30, 2004	As of June 30, 2003
Assets			
Current assets	\$63,475,906	\$62,820,908	\$58,044,943
Noncurrent assets:			
Capital assets	3,295,311	4,151,722	4,986,696
Other noncurrent assets	79,296,246	74,824,261	84,851,619
Total noncurrent assets	82,591,557	78,975,983	89,838,315
Total assets	146,067,463	141,796,891	147,883,258
Liabilities			
Current liabilities	63,585,194	63,253,674	58,782,912
Long-term liabilities	72,158,873	69,260,724	73,015,880
Total liabilities	135,744,067	132,514,398	131,798,792
Net Assets			
Invested in capital assets	3,295,311	4,151,722	4,986,696
Unrestricted	(3,295,311)	(4,151,722)	(4,986,696)
Restricted	10,323,396	9,282,493	16,084,466
Total net assets	\$10,323,396	\$9,282,493	\$16,084,466

The MLC current assets consist primarily of cash and cash equivalents with the State Treasurer, accounts receivable from ticket sellers and investments held on behalf of grand-prize winners (current portion). Capital assets consist of land, buildings, vehicles, computers and other equipment. Other noncurrent assets consist primarily of investments held on behalf of grand-prize winners (noncurrent). Current liabilities consist primarily of accrued prizes payable, the amount due the Lottery Proceeds Fund, and general accounts payable to suppliers. Long-term liabilities include the long-term portion of amounts payable to grand-prize winners. Net assets invested in capital assets are unrestricted. Net assets restricted for unrealized gains on investments held for grand-prize winners are presented in compliance with GASB 31 and represent the net market value adjustment of investments held to maturity.

MLC Changes in Net Assets

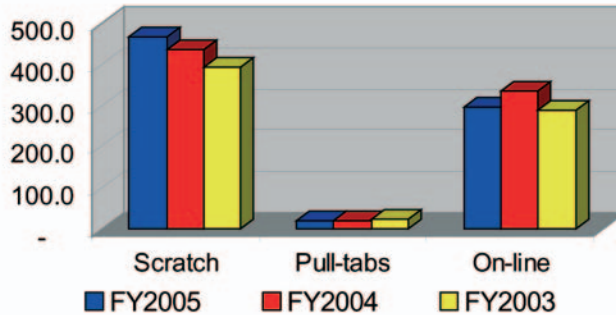
	For the Year Ended June 30, 2005	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003
Operating revenues			
On-line ticket sales	\$297,540,450	\$334,515,765	\$289,025,023
Scratchers ticket sales	467,326,093	434,791,673	393,981,254
Pull-Tab ticket sales	20,731,089	21,846,920	25,041,235
Other ticket sales	340,957	638,392	539,609
Total operating revenues	<u>785,938,589</u>	<u>791,792,750</u>	<u>708,587,121</u>
Nonoperating revenues	<u>14,702,347</u>	<u>12,753,862</u>	<u>28,425,420</u>
Total revenues	<u>800,640,936</u>	<u>804,546,612</u>	<u>737,012,541</u>
Operating expenses			
Direct costs:			
Prize expense	487,925,882	484,827,462	434,559,460
Retailer commissions and incentives	48,798,722	49,316,766	44,453,462
Other direct costs	17,543,004	18,341,746	16,712,029
Total direct costs	554,267,608	552,485,974	495,724,951
Administrative expenses	21,430,609	22,619,483	26,561,873
Total operating expenses	<u>575,698,217</u>	<u>575,105,457</u>	<u>522,286,824</u>
Nonoperating expenses			
Transfers to the State of Missouri	218,642,710	229,427,183	203,466,261
Other nonoperating expenses	5,259,106	6,815,945	5,473,304
Total nonoperating expenses	<u>223,901,816</u>	<u>236,243,128</u>	<u>208,939,565</u>
Total expenses	<u>799,600,033</u>	<u>811,348,585</u>	<u>731,226,389</u>
Changes in net assets	<u>\$1,040,903</u>	<u>(\$6,801,973)</u>	<u>\$5,786,152</u>

Changes in net assets are the result of fluctuations in market yields which increase or reduce the unrealized gain on investments.

Operating Revenues

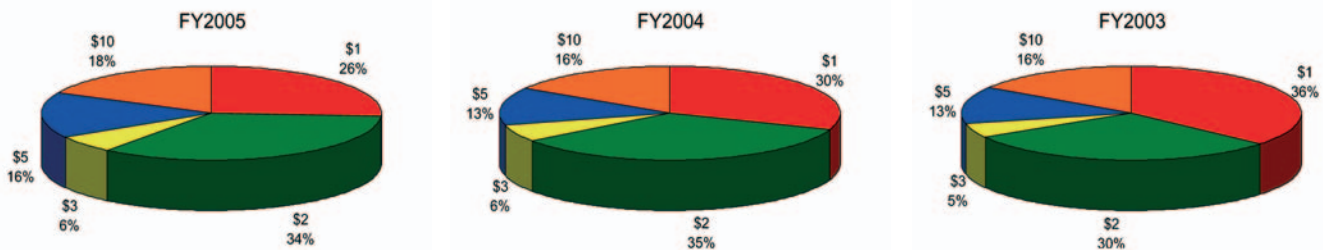
	2005	2004	2003
Sales by Game			
Scratch	\$467,326,093	\$434,791,673	\$393,981,254
Pull-tabs	20,731,089	21,846,920	25,041,235
Lotto	30,311,403	35,015,934	28,736,839
Pick 3	60,558,754	53,946,082	53,569,248
Pick 4	21,338,535	18,436,614	16,157,968
Show-Me 5 Paydown	23,056,447	24,337,775	22,665,639
Club Keno	47,616,083	51,531,568	42,570,878
Powerball	114,485,380	147,232,847	125,324,451
Xtra	173,848	4,014,945	0
Other	340,957	638,392	569,609

Lottery Sales By Product in millions



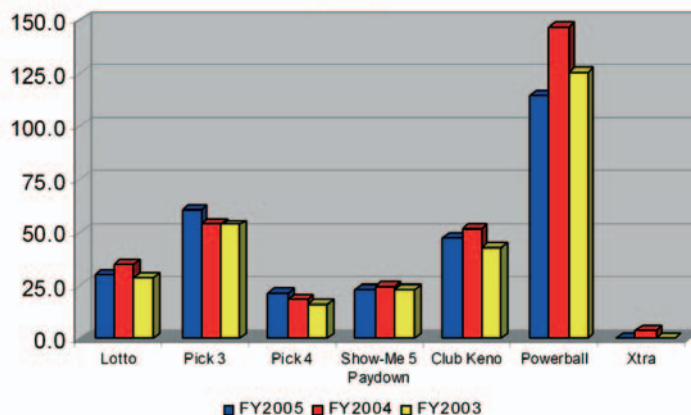
Revenues from the sale of lottery products decreased in fiscal year 2005 following a record sales year in fiscal year 2004. While overall sales declined, scratch ticket sales continued to increase in fiscal year 2005. Starting in fiscal year 2002 and continuing through fiscal years 2003, 2004 and 2005, the MLC has made a significant investment in increasing prizes and introducing more \$2, \$5, and \$10 tickets. The resulting increase in the ratio of sales for higher price point games continues to lead to overall sales increases in scratch ticket sales.

Scratch Ticket Sales By Price Point



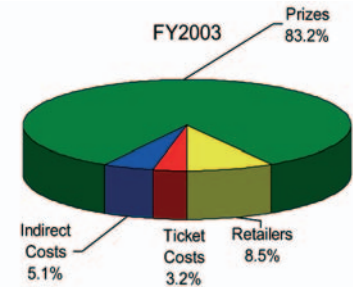
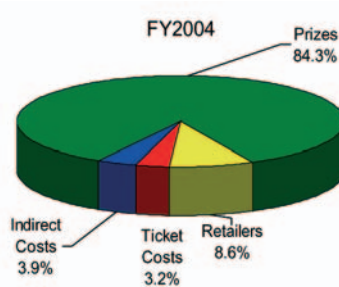
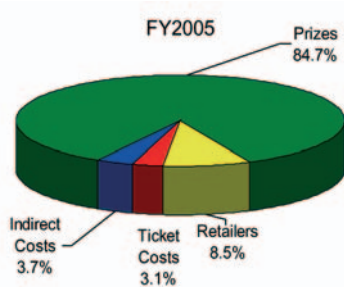
The on-line sales decrease in fiscal year 2005 was due primarily to a drop in sales of the Powerball game. Several large jackpots during fiscal year 2004 contributed to record sales for this game as sales are driven by high jackpot amounts. Lotto sales were also higher in fiscal year 2004 due to a large jackpot that drove sales for that year. There were no comparable jackpots in either fiscal year 2005 or fiscal year 2003. Sales for the Pick 3 and Pick 4 games increased in fiscal year 2005 with the addition of a second daily draw. Club Keno and Show-Me 5 Paydown sales decreased in fiscal year 2005 after increasing in fiscal year 2004. Pull-tabs are sold in the same market environment as Club Keno and also experienced a slight decline in sales.

On-line Sales By Game in millions



Operating Expenses

	2005	2004	2003
Game related			
Prizes	\$487,925,882	\$484,827,462	\$434,559,460
Retailer commissions and incentives	48,798,722	49,316,766	44,453,462
Tickets	7,431,856	7,016,196	6,507,982
On-line vendor fees	10,111,148	11,325,550	10,204,047
Non-game related			
Advertising	2,110,182	3,048,387	5,645,268
Wages and benefits	9,086,615	8,505,183	8,360,125
Other general expenses	10,233,812	11,065,913	12,556,480



Of the MLC total operating expenses of \$575.7 million in fiscal year 2005, \$554.2 million, or 96.3%, are game related, or direct, expenses. In fiscal year 2004, direct expenses were \$552.4 million, or 96.1%, of the total \$575.1 million total operating expenses for the year. In fiscal year 2003, direct expenses were 94.9%, of total operating expenses. In fiscal year 2005, direct expenses increased due to a continued increase in the aggregate prize expense as a percentage of scratch ticket sales, as discussed above. The increase in all direct expenses in fiscal year 2004 is associated with the increase in product sales.

Non-Operating Revenues (Expenses)

	2005	2004	2003
Interest	\$571,049	\$470,448	\$382,523
Unclaimed prizes	7,811,413	12,283,414	16,720,584
Net increase (decrease) in investments held	6,300,009	(1,546,223)	11,259,456
Amortization of grand-prize winner liability	(5,259,106)	(5,255,750)	(5,473,304)
Gain (loss) on capital asset disposal	19,876	(13,972)	62,857
Transfers to State of Missouri	(218,642,710)	(229,427,183)	(203,466,261)

The MLC retains prize money if a claim for the prize is not made within a specified time. During fiscal year 2003 this claim period was shortened from one year to 180 days. This change caused an increase in unclaimed prize amounts in fiscal year 2003 and a continued residual effect in fiscal year 2004 as the full effect of the change took place over a one year period. Unclaimed prize amounts in fiscal year 2005 returned to levels comparable to fiscal year 2002.

Net increase in investments held for grand-prize winners represents the net market value change as required to be reported per GASB 31. Amortization of grand-prize winner liability represents the accretion of interest to the securities held to maturity to fund the grand-prize winner payments.

All net proceeds are transferred to the Lottery Proceeds Fund for Education. Net proceeds for fiscal year 2005 decreased 10.8 million, or 4.7%, from fiscal year 2004. For fiscal year 2004, proceeds increased \$25.5 million, or 12.5%, over fiscal year 2003. The governor's office and the legislature determine where these funds will be expended within the state's public institutions of elementary, secondary and higher education. The Missouri Department of Elementary and Secondary Education was appropriated \$143.9 million in fiscal year 2005 and \$121.1 million in fiscal year 2004 and the Missouri Department of Higher Education received \$76.4 million in fiscal year 2005 and \$75.5 million in fiscal year 2004.

Capital Assets and Long-Term Debt

The MLC capital assets consist of land, buildings, vehicles, computers and other equipment. Capital assets decreased in fiscal years 2005 and 2004 because depreciation expense was greater than capital asset acquisitions. Capital assets are not a significant part of MLC total assets.

The MLC has no long-term liabilities other than the long-term annuitized payments to lottery winners and deferred transfers to the State of Missouri. Additional detailed information on capital assets and long-term liabilities may be found in the accompanying notes to the financial statements.

Contacting MLC Financial Management

This management discussion and analysis report is designed to provide Missouri citizens, government officials, players, retailers and other interested parties with reliable financial information and an explanation of the MLC financial activities for the years ended June 30, 2005 and 2004. If you have questions about this report or need additional information, contact Missouri State Lottery Commission, Financial Accounting Section, P.O. Box 1603, Jefferson City MO 65109-1603.

Missouri State Lottery Commission
(A Component Unit of the State of Missouri)

Statements Of Net Assets As Of June 30, 2005 and 2004

	2005	2004
Current Assets:		
Cash and cash equivalents	\$ 11,264,524	\$ 13,043,137
Investments held for grand prize winners at fair value	11,065,276	10,515,074
Accounts receivable, net of allowances for returns and doubtful accounts	39,853,800	38,527,588
Other receivable	567,321	644,851
Prepaid expense	724,985	90,258
Total current assets	63,475,906	62,820,908
Noncurrent Assets:		
Investments held for grand prize winners at fair value	79,296,246	74,824,261
Capital assets:		
Capital assets not being depreciated	352,973	352,973
Capital assets	20,147,487	20,680,735
Accumulated depreciation	(17,205,149)	(16,881,986)
Total noncurrent assets	82,591,557	78,975,983
Total assets	146,067,463	141,796,891
Current Liabilities:		
Accounts payable	251,056	412,294
Due to Lottery Proceeds Fund	19,023,287	18,214,452
Accrued prize liabilities	30,207,044	31,167,766
Grand prize winner liabilities	11,216,000	10,584,000
Other accrued liabilities	2,887,807	2,875,162
Total current liabilities	63,585,194	63,253,674
Long-term Liabilities:		
Due to Lottery Proceeds Fund - Deferred	3,336,747	3,787,882
Long-term grand prize winner liabilities at present value	68,822,126	65,472,842
Total long-term liabilities	72,158,873	69,260,724
Total liabilities	135,744,067	132,514,398
Net Assets:		
Invested in capital assets	3,295,311	4,151,722
Unrestricted	(3,295,311)	(4,151,722)
Restricted	10,323,396	9,282,493
Total net assets	\$ 10,323,396	\$ 9,282,493

The accompanying notes are an integral part of these financial statements.

Missouri State Lottery Commission
(A Component Unit of the State of Missouri)

Statements Of Revenues, Expenses And Changes In Fund Net Assets
For The Years Ended June 30, 2005 and 2004

	2005	2004
Operating Revenues:		
On-line ticket sales	\$ 297,540,450	\$ 334,515,765
Scratch ticket sales	467,326,093	434,791,673
Pull-tab ticket sales	20,731,089	21,846,920
Total sales	785,597,632	791,154,358
Other	340,957	638,392
Total operating revenues	785,938,589	791,792,750
Operating Expenses:		
On-line prize expense	162,322,731	181,060,223
Scratch prize expense	312,477,552	290,005,348
Pull-tab prize expense	13,125,599	13,761,891
On-line retailer commissions and incentives	17,212,524	19,147,892
Scratch retailer commissions and incentives	30,272,992	28,421,256
Pull-tab retailer commissions and incentives	1,313,206	1,747,618
Cost of tickets sold	17,543,004	18,341,746
Advertising	2,110,182	3,048,387
Wages and benefits	9,086,615	8,505,183
Other general and administrative	9,148,112	9,705,290
Depreciation and amortization	1,085,700	1,360,623
Total operating expenses	575,698,217	575,105,457
Operating income	210,240,372	216,687,293
Nonoperating Revenues (Expenses):		
Interest income	571,049	470,448
Unclaimed prizes	7,811,413	12,283,414
Net increase (decrease) in the fair value of investments held for grand prize winners	6,300,009	(1,546,223)
Amortization of grand prize winner liability	(5,259,106)	(5,255,750)
Gain (loss) on disposal of capital assets	19,876	(13,972)
Transfers to State of Missouri	(218,642,710)	(229,427,183)
Total nonoperating expense	(209,199,469)	(223,489,266)
Changes in net assets	1,040,903	(6,801,973)
Total Net Assets, Beginning Of Year	9,282,493	16,084,466
Total Net Assets, End Of Year	\$ 10,323,396	\$ 9,282,493

The accompanying notes are an integral part of these financial statements.

Missouri State Lottery Commission
(A Component Unit of the State of Missouri)

Statements Of Cash Flows
For The Years Ended June 30, 2005 and 2004

	2005	2004
Cash Flows From Operating Activities:		
Cash received from retailers	\$ 784,423,007	\$ 789,581,039
Cash received from others	266,900	(55,514)
Cash paid for prizes	(491,659,191)	(478,616,771)
Cash paid for retailer commissions	(48,775,716)	(49,131,813)
Cash paid for employee services	(9,097,537)	(8,466,630)
Cash paid for other expenses	(29,596,702)	(31,062,086)
Net cash provided by operating activities	<u>205,560,761</u>	<u>222,248,225</u>
Cash Flows From Noncapital Financing Activities:		
Transfers to State of Missouri	<u>(218,285,010)</u>	<u>(230,318,233)</u>
Cash Flows From Capital And Related Financing Activities:		
Purchases of capital assets	(238,636)	(586,934)
Proceeds from sale of capital assets	<u>29,223</u>	<u>47,313</u>
Net cash used for capital and related financing activities	<u>(209,413)</u>	<u>(539,621)</u>
Cash Flows From Investing Activities:		
Proceeds from maturity of investments	10,584,000	10,434,000
Interest received	<u>571,049</u>	<u>470,448</u>
Net cash provided by investing activities	<u>11,155,049</u>	<u>10,904,448</u>
Net increase (decrease) in cash and cash equivalents	(1,778,613)	2,294,819
Cash And Cash Equivalents, Beginning Of Year	<u>13,043,137</u>	<u>10,748,318</u>
Cash And Cash Equivalents, End Of Year	<u><u>\$ 11,264,524</u></u>	<u><u>\$ 13,043,137</u></u>
Reconciliation Of Operating Income To Net Cash Provided By Operating Activities:		
Operating income	\$ 210,240,372	\$ 216,687,293
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,085,700	1,360,623
Unclaimed prizes	7,811,413	12,283,414
Payments to grand prize winners	(10,584,000)	(10,434,000)
Changes in operating assets and liabilities:		
Accounts receivable	(1,326,212)	(1,635,374)
Other receivable	77,530	(631,851)
Prepaid expense	(634,727)	(90,258)
Accounts payable and other accrued liabilities	(148,593)	347,101
Accrued prize liabilities	(960,722)	4,361,277
Net cash provided by operating activities	<u><u>\$ 205,560,761</u></u>	<u><u>\$ 222,248,225</u></u>
Non-cash Activities:		
Unrealized gains (losses) on investments held for grand prize winners	\$ 6,300,009	\$ (1,546,223)
Amortization of long-term annuity prize liability	\$ 5,259,106	\$ 5,255,750

The accompanying notes are an integral part of these financial statements.

Missouri State Lottery Commission
(A Component Unit of the State of Missouri)

Notes To Basic Financial Statements
June 30, 2005 and 2004

1. Summary of Significant Accounting Policies:

The Missouri State Lottery Commission (the Lottery) was created by the passage of a constitutional amendment on November 6, 1984 by the citizens of the State of Missouri. The Lottery is a Type III division assigned to the Missouri Department of Revenue as defined in Section 313.210 of the Missouri Revised Statutes. The Department of Revenue has no control, supervision, or authority over the actions or decisions of the Lottery. The Commission consists of five members appointed by the Governor with the advice and consent of the Senate. The day-to-day operations are administered by the executive director and administrative staff as designated by the Commission. In accordance with Governmental Accounting Standards Board Statement No. 14, the Lottery, although a legally separate entity, is considered to be a component unit of the State of Missouri. This component unit provides services which exclusively, or almost exclusively, benefit the State of Missouri.

Basis of Presentation

The Lottery is accounted for as a proprietary-type enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or where the periodic determination of net income is appropriate. In reporting its financial activities, the Lottery applies all applicable private sector standards of accounting and financial reporting issued prior to December 1, 1989, to the extent that these standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board (GASB).

Basis of Accounting

The financial statements of the Lottery have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of accounting refers to when revenues, expenses and the related assets and liabilities are recognized in the accounts and reported in the financial statements. Measurement focus refers to what is being measured. The financial statements are prepared on the accrual basis of accounting and on an economic resources measurement focus in accordance with GAAP.

The Lottery distinguishes operating revenue and expenses from nonoperating items. The principal operating revenue of the Lottery is primarily comprised of sales from scratch, pull-tab and on-line tickets. Operating expenses mainly consist of payments to prize winners, commissions to retailer agents and payments to vendors and employees.

Revenue Recognition

Sales of on-line lottery tickets are generated by the semiweekly "LOTTO" and "Powerball" games, and the daily "Club Keno", "Show-Me 5 Paydown", "PICK 4", "PICK 3", and Xtra games. Sales of on-line lottery tickets are made through licensed retail sales outlets via on-line terminals maintained by the retailers. Ticket sales are recognized at the time the player purchases a ticket from the retailer.

Sales of scratch lottery tickets are made to licensed retail sales outlets with the right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player. Allowances of approximately \$1,593,000 and \$957,000 at June 30, 2005 and 2004, respectively, have been established for estimated tickets to be returned by retailers.

Sales of pull-tab lottery tickets are made to licensed retail sales outlets with no right of return. Ticket sales are recognized upon the sale of tickets to retailers and are valued at the sale price to the player.

Prizes

Expenses for on-line lottery ticket prizes are recorded based on a minimum of 45% of on-line lottery ticket sales. This amount is recognized and accrued as prize liability. Actual prizes paid are treated as a reduction of the prize liability.

Grand prize winners have the choice of receiving the prize in 25 annual installments or a portion of the prize in one lump-sum payment.

Expenses for scratch lottery ticket and pull-tab lottery ticket prizes are recorded based upon the unique, predetermined prize structure for each game and are accrued as tickets are sold to the retailer.

Unclaimed Prizes

State statutes require that unclaimed prize monies be retained by the Lottery for the person entitled thereto for 180 days after the time the prize was awarded. If no claim is made for the prize within such time, the prize money reverts to the Lottery. Effective July 1, 2000, at the directive of the State of Missouri, the Lottery transfers to the Lottery Proceeds Fund all prizes that remain unclaimed. During the years ended June 30, 2005 and 2004, unclaimed prizes in the amount of approximately \$7,800,000 and \$12,300,000, respectively, were transferred to the Lottery Proceeds Fund. For the years ended June 30, 2005 and 2004, this amount has been included as nonoperating revenue on the statement of revenues, expenses and changes in fund net assets with a corresponding amount included as a transfer to State of Missouri.

Cash and Cash Equivalents

For purposes of the cash flows statement, cash and cash equivalents consist of cash in banks, repurchase agreements and cash and money market funds on deposit with the State Treasurer. The Lottery considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Investments Held for Grand Prize Winners

Since March 1990, to fund future payments under grand prize winner prize claims, the Lottery purchases U.S. Treasury zero coupon bonds, with maturities approximating deferred grand prize annuity installment amounts and due dates. The securities purchased are held in the Lottery's name in safekeeping by the Federal Reserve Bank in a separate account. The investments in these securities are carried at fair value.

Retailer Fees

Licensed retailers are charged a fee for the right to sell lottery tickets. Additionally, certain retailers pay an annual fee in lieu of obtaining an insurance bond. Such fees are maintained in a reserve fund to offset uncollectable accounts receivable from retailers. This reserve fund had no balance at June 30, 2005 and approximately \$151,000 at June 30, 2004, and is reflected as a reduction of accounts receivable on the accompanying statements of net assets.

Capital Assets

Property and equipment greater than \$1,000 are carried at cost, less accumulated depreciation. Property and equipment received as settlement for liquidated damages are recorded at fair value on the date received. Depreciation is computed on the straight-line method over the estimated lives of the related assets, which range from three to fifteen years for autos, computers, equipment, and other assets and nineteen years for buildings. When assets are retired or otherwise disposed, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in nonoperating revenues and expenses for the period.

Net Assets

Restricted net assets represent the unrealized gains or losses on investments held for grand prize winners. GASB Statement No. 31 requires that certain investments be reported at fair value with gains and losses reflected in the statement of operations. As required by the Missouri Constitution and state statutes, the Lottery uses investments only to fund its annuity prize obligations and intends to hold the investments to maturity. Market gains or losses represent temporary fluctuations and are not recognized in the calculation of the amounts due to the Lottery Proceeds Fund.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Due Lottery Proceeds Fund

All income before transfers of the Lottery, except for net increase in the fair value of investments held for grand prize winners and amortization of grand prize winner liabilities, as described in the accompanying statements of revenues, expenses and changes in fund net assets, accrues to the benefit of the State of Missouri. Transfers are made to the Lottery Proceeds Fund, which shall be appropriated by the State solely for the institutions of elementary, secondary and higher education.

Transfers are made monthly and are based on estimated net income before transfers. A portion of the liability to the Lottery Proceeds Fund, equal to the net book value of capital additions after September 1, 1988, and all amounts receivable from the Multi-State Lottery Association, is deferred and is not subject to current transfers.

Compensated Absences

Under the terms of the Lottery's personnel policy, employees are granted vacation and sick leave in varying amounts, based upon length of service. In the event of termination or separation, an employee is generally paid for accumulated vacation up to 240 hours if in service for less than ten years; 288 hours for service between ten and fifteen years; and 336 hours if service exceeds fifteen years. Accordingly, it is the Lottery's policy to record vacation pay as an expense as it is earned. The amount of earned but unused accumulated vacation is included as an accrued liability in the accompanying financial statements.

Retiring employees receive an additional month of credited service for every twenty-one days of accumulated sick leave on the date of termination. Credited service is used to calculate retirement benefits administered by the Missouri State Employees Retirement System. The amount of earned but unused sick leave has no material financial effect on the Lottery.

Risk Management

The Lottery's risk management activities for workers' compensation and unemployment are recorded in the Workers' Compensation Fund and the Employment Security Fund, funds of the State of Missouri. The Lottery reimburses these funds for actual disbursements made on the Lottery's account.

Employees are offered various health insurance coverage programs administered by the Missouri Consolidated Health Care Plan (MCHCP). The Lottery contributes a fixed monthly payment for each covered employee to MCHCP as appropriated by the General Assembly of the State of Missouri.

The Lottery's major assets including data processing equipment, buildings, and business interruption are insured by a third party carrier maintained by the Office of Risk Management.

There were no significant reductions in insurance coverage from the prior year. Insurance settlements did not exceed insurance coverage in the past three years.

Budgetary Authority

The Lottery annually submits a request for appropriation through the budgetary process of the State of Missouri. All expenses of the Lottery are subject to the State of Missouri appropriation process.

2. Statutory Requirements:

Missouri statutes provide that a minimum of 45% of the money received from the sale of lottery tickets shall be allocated to prizes. The costs of operating the Lottery, including all commissions to retailers, promotional costs, and all other administrative expenditures, are appropriated by the General Assembly of the State of Missouri.

The Lottery receives certain services for no charge from other Missouri state government agencies. Investigative services are provided by the Missouri State Highway Patrol. The Office of Administration provides certain services to process expenditures and payroll for the Lottery.

3. Cash and Cash Equivalents:

Cash, other than petty cash and the imprest fund, is part of the common cash pool in the State Treasury. The State of Missouri invests such cash in excess of what is necessary to meet current obligations. The fair value in the common cash pool is the same as the value of the pool shares. At June 30, 2005 and 2004, the Lottery's share in the State's common cash pool was \$7,365,556 and \$208,989, respectively. At June 30, 2005 and 2004, the book balance of the imprest fund was \$3,896,867 and \$12,832,048, respectively, and the bank balance was \$4,447,647 and \$13,322,012, respectively.

Collateral is required by state statutes for demand deposits and certificates of deposit. The fair value of collateral must equal 100% of deposits not covered by federal deposit insurance. Obligations that may be pledged as collateral are governed by state statute and include U.S. government and U. S. agency bonds and securities, general obligation bonds of any of the fifty states, general obligation bonds of any Missouri county and certain cities and special districts, and revenue bonds of certain Missouri agencies. Written custodial agreements are required which provide, among other things, that the collateral be held separate from the assets of the custodial bank.

4. Investments Held for Grand Prize Winners:

As provided for by Article III, Section 39(b) of the Missouri Constitution, the Lottery purchases United States Treasury Zero Coupon Bonds for the specific purpose of funding future grand prize winner prize claims. These investments are carried at fair value in the amounts of \$90,361,522 and \$85,339,335 at June 30, 2005 and 2004, respectively. The maturity value of securities held at June 30, 2005 and 2004 was \$114,883,000 and \$109,339,000, respectively.

At June 30, 2005, the Lottery had the following investments:

Investment Type	Fair Value	Investment Maturities (In Years)			
		Less Than 1	1-5	6-10	More Than 10
<u>Investments in prize annuities:</u>					
United States Treasury Zero Coupon Bonds	\$90,361,522	\$11,065,276	\$48,028,461	\$20,300,353	\$10,967,432

Investments in prize annuities are subject to changes in fair value due to interest rate risk. However, to satisfy the annual installment obligations to prize winners, these bonds are held to maturity. The fair value at maturity is the face value of the bonds, regardless of the changes in value during the time that the investments are outstanding.

5. On-Line Ticket Sales:

On-line ticket sales consist of the following:

	2005	2004
Powerball	\$ 114,485,380	\$ 147,232,847
Pick 3	60,558,754	53,946,082
Lotto	30,311,403	35,015,934
Show-Me 5 Paydown	23,056,447	24,337,775
Pick 4	21,338,535	18,436,614
Club Keno	47,616,083	51,531,568
Xtra	173,848	4,014,945
	<u>\$ 297,540,450</u>	<u>\$ 334,515,765</u>

6. Capital Assets:

The changes in capital assets consist of the following:

	June 30, 2004	Increases	Decreases	June 30, 2005
Capital assets not being depreciated:				
Land	\$ 352,973	\$ 0	\$ 0	\$ 352,973
Capital assets being depreciated:				
Buildings	4,291,899	63,398	0	4,355,297
Computers	4,048,136	109,812	93,091	4,064,857
Equipment	10,828,470	45,160	503,284	10,370,346
Automobiles	1,467,230	20,266	175,509	1,311,987
Other	45,000	0	0	45,000
Total capital assets being depreciated	<u>20,680,735</u>	<u>238,636</u>	<u>771,884</u>	<u>20,147,487</u>
Less accumulated depreciation for:				
Buildings	2,546,820	220,451	0	2,767,271
Computers	2,935,362	449,459	92,027	3,292,794
Equipment	10,260,819	215,487	495,000	9,981,306
Automobiles	1,125,662	198,803	175,510	1,148,955
Other	13,323	1,500	0	14,823
Total accumulate depreciation	<u>16,881,986</u>	<u>\$ 1,085,700</u>	<u>\$ 762,537</u>	<u>17,205,149</u>
Total capital assets being depreciated, net	<u>3,798,749</u>			<u>2,942,338</u>
Capital assets, net	<u>\$ 4,151,722</u>			<u>\$ 3,295,311</u>

	June 30, 2003	Increases	Decreases	June 30, 2004
Capital assets not being depreciated:				
Land	\$ 352,973	\$ 0	\$ 0	\$ 352,973
Capital assets being depreciated:				
Buildings	4,291,899	0	0	4,291,899
Computers	3,861,458	311,327	124,649	4,048,136
Equipment	10,878,620	115,164	165,314	10,828,470
Automobiles	1,585,122	160,443	278,335	1,467,230
Other	45,000	0	0	45,000
Total capital assets being depreciated	20,662,099	586,934	568,298	20,680,735
Less accumulated depreciation for:				
Buildings	2,319,723	227,097	0	2,546,820
Computers	2,649,154	401,830	115,622	2,935,362
Equipment	9,932,968	440,907	113,056	10,260,819
Automobiles	1,114,712	289,285	278,335	1,125,662
Other	11,819	1,504	0	13,323
Total accumulate depreciation	16,028,376	\$ 1,360,623	\$ 507,013	16,881,986
Total capital assets being depreciated, net	4,633,723			3,798,749
Capital assets, net	\$ 4,986,696			\$ 4,151,722

7. Pension Plan:

The Lottery participates in the Missouri State Employees' Retirement System (MOSERS) plan, a cost-sharing multiple employer defined benefit retirement plan covering all the employees of the State of Missouri. The plan is administered by the MOSERS Board of Trustees in accordance with Sections 104.010 and 104.312 to 104.800 of the Revised Statutes of Missouri. Substantially all full-time employees of the Lottery are covered by the plan. MOSERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to: Missouri State Employees' Retirement System, 907 Wildwood Drive, P.O. Box 209, Jefferson City, Missouri 65102, or by calling (800) 827-1067.

The Plan provides retirement, death and disability benefits to its members. Benefits for state employees are fully vested after five years of credited service. Employees may retire on or after age 55 and receive reduced benefits (full benefits if they are at least age 50 and their combined age and service equal 80). The Plan cannot be terminated. The Lottery's full time employees do not contribute to the Plan. The State of Missouri is required to make all contributions at an actuarially determined rate. The current rate of contribution for retirement and long-term disability is 10.64% and 0.57% of total payroll, respectively.

For fiscal years ended June 30, 2005, 2004, 2003 and 2002, the annual pension cost was approximately \$751,000, \$639,000, \$602,000, and \$778,000 respectively, and was equal to 100% of the annual pension cost required to be contributed for those years.

8. Leases:

Operating Leases

The Lottery's regional facilities are held under operating lease agreements through June 30, 2005, with renewal options available for one to three additional one-year periods. Annual rent expense for these facilities totaled approximately \$291,000 and \$316,000 in fiscal 2005 and 2004, respectively.

The Lottery leases ticket vending machines under operating lease agreements through June 30, 2005, with options available for additional one-year periods. Annual lease expense for these machines totaled approximately \$691,000 and \$576,000 in fiscal 2005 and 2004, respectively.

9. Contractual Arrangements:

The Lottery maintains contractual arrangements with providers of goods and services critical to the Lottery's operations. Significant contracts include an agreement with the provider of the Lottery's on-line game computer systems and agreements with producers of the Lottery's scratch and pull-tab games tickets, among others. The contracts generally run for one year, with one-year renewals available at the option of the Lottery. The contracts require the Lottery to compensate vendors for goods and services that meet stated quality standards.

The Lottery is a member of the Multi-State Lottery Association (MUSL) which consists of 29 state and district lotteries (member lotteries) and operates the on-line Powerball game. Under separate agreements between MUSL and each lottery, the member lotteries sell tickets for the Powerball game and remit 50% of sales to prize winners or to MUSL for payment of prizes. Member lotteries also fund MUSL's operating expenses based on allocations by MUSL.

Powerball grand prize winners have the choice of receiving the prize in 30 annual installments or a portion of the prize in one lump-sum payment. Investment securities, with maturities that approximate all grand prize winner payments due to winners of MUSL games, are maintained by MUSL. The investments and related prize liabilities for winners of these games from the state of Missouri are excluded from the accompanying financial statements. Future grand prize winner payments of MUSL games due to winners in Missouri are approximately \$84,954,000 and \$96,289,000 as of June 30, 2005 and 2004, respectively.

The Lottery has contributed to a prize reserve fund and set prize reserve fund, separately maintained by MUSL, to protect MUSL members in case of unforeseen liabilities and to pay certain prizes associated with Powerball, respectively. With certain restrictions, these fund balances are refundable to member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 2005 and 2004, the Lottery's portion of the prize reserve fund and set prize reserve fund was approximately \$4,939,000 and \$5,013,000, respectively, and \$1,453,000 and \$1,671,000, respectively. The Lottery has charged amounts placed into the prize reserve funds to prize expense as the related sales have occurred.

The Lottery has contributed to an account with MUSL which is used to pay certain operating expenses incurred by member lotteries for the Powerball game. With certain restrictions, the balances in this account are refundable to the member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 2005 and 2004, the Lottery's portion of the balance of this account was approximately \$522,000 and \$221,000, respectively, and is reported as a receivable.

10. Amounts Held On Behalf Of Grand Prize Winners Liability:

The Lottery has an implied contract to make future installment payments to grand prize winners, and as such, recognizes this as amounts held on behalf of grand prize winners. Amounts due to grand prize winners are carried at the estimated present value of the prizes that will eventually be awarded. The present value of these payments at June 30, 2005 and 2004 was \$80,038,126 and \$76,056,842, respectively. This is funded with the maturing U.S. Treasury zero coupon bonds that are restricted for this purpose. The balances of these maturities at June 30, 2005, are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2006	\$ 11,216,000
2007	11,206,000
2008	11,206,000
2009	11,206,000
2010	10,868,000
2011 through 2015	33,575,000
2016 through 2020	12,778,000
2021 through 2025	8,942,000
2026 through 2029	3,886,000
Total installment payments due	114,883,000
Less- Interest portion	34,844,874
	<u>\$ 80,038,126</u>

Prior to March 1990, the Lottery purchased annuity contracts in the name of the prize winners from selected insurance companies to fund the "LOTTO" grand prize claims. Because it is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner, neither the value of the annuities nor

the value of the related future payments are reflected in the accompanying financial statements. The Lottery would assume liability for future payments if the insurance companies were to default on their payments. Future payments to be made to grand prize winners by these insurance companies totaled approximately \$12,651,000 and \$18,761,000 at June 30, 2005 and 2004, respectively.

11. Long Term Liabilities:

The changes in long-term liabilities consist of the following:

	<u>June 30, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2005</u>	<u>Current Portion</u>
Due to Lottery Proceeds Fund	\$ 22,002,334	\$218,642,710	\$218,285,010	\$ 22,360,034	\$ 19,023,287
Grand prize winner liabilities	76,056,842	14,565,284	10,584,000	80,038,126	11,216,000
Total	<u>\$ 98,059,176</u>	<u>\$233,207,994</u>	<u>\$228,869,010</u>	<u>\$102,398,160</u>	<u>\$ 30,239,287</u>
	<u>June 30, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2004</u>	<u>Current Portion</u>
Due to Lottery Proceeds Fund	\$ 22,893,384	\$229,427,183	\$230,318,233	\$ 22,002,334	\$ 18,214,452
Grand prize winner liabilities	79,158,564	7,332,278	10,434,000	76,056,842	10,584,000
Total	<u>\$102,051,948</u>	<u>\$236,759,461</u>	<u>\$240,752,233</u>	<u>\$ 98,059,176</u>	<u>\$ 28,798,452</u>

12. Contingencies:

There are claims and/or lawsuits to which the Lottery is a party as a result of matters arising in the ordinary course of business. The final outcome of any claim or lawsuit is not presently determinable. Management does not anticipate the resolution of these matters to have a material adverse effect on the financial condition of the Lottery.

Statistical Section

(Unaudited)



Missouri Lottery Statistics

Information for the Missouri Lottery for the last ten fiscal years, 1996 through 2005, is presented in the accompanying schedules and charts. The Missouri Lottery was created on November 6, 1984 by the passage of a constitutional amendment and began selling tickets in January 1986.

The following information is presented in the accompanying schedules and charts:

Revenue – includes sales, interest income, retailer fees and other income amounts. Interest income does not reflect interest from investments for Lotto payments.

Sales – reflects the face value of lottery tickets.

Retailer compensation – includes the base commission and cashing, promotional and program incentive payments.

Prizes – reflects the liability incurred for payments to winners.

Ticket costs – includes the purchase cost of instant and pull-tab tickets and payments to the on-line games service provider.

Administration – includes all operating expenses not included in prizes, retailer commissions and incentives or ticket costs.

Transfers to the State – reflects the transfer of net income, excluding unrealized gains on investments and amortization of grand prize winner liability, to the Lottery Proceeds Fund for fiscal years 1996 through 2005. Transfers made during fiscal year 2005 include \$7,811,413 of unclaimed prizes. The Lottery Proceeds Fund is appropriated by the Missouri State General Assembly to the Department of Higher Education and the Department of Elementary and Secondary Education. Profits not yet transferred are shown on the balance sheet as a liability.

Expenses and transfers – includes prizes, retailer commissions and incentives, ticket costs and administration costs as described above, as well as transfers made to the state.

Unless otherwise noted, the source for the data used to prepare the following schedules and charts is the Division of Finance and Administration of the Missouri Lottery.

Missouri Lottery

Sales and Other Revenues Fiscal Years 1996 through 2005

	FY96	FY97	FY98	FY99
Scratch Tickets	\$198,735,269	\$222,342,990	\$257,643,316	\$248,510,434
Lotto	32,683,662	31,892,109	27,875,180	24,981,515
Pick 3	46,609,753	48,362,345	49,711,706	45,622,562
Powerball	89,376,918	76,145,527	101,082,612	132,599,484
Show-Me 5	25,534,373	22,783,598	23,666,577	23,537,442
Pick 4	-	-	-	8,759,037
Club Keno	-	-	-	-
Daily Millions	-	9,573,752	5,180,039	-
Xtra	-	-	-	-
Triple Play	-	-	-	-
Total On-Line	194,204,706	188,757,331	207,516,114	235,500,040
Pull-Tab Tickets	29,590,970	28,491,979	29,139,331	29,240,982
Total Sales	422,530,945	439,592,300	494,298,761	513,251,456
Interest income	1,124,258	1,045,038	945,708	1,518,063
Other income	291,825	292,490	185,404	1,597,855
Total Other Revenues	1,416,083	1,337,528	1,131,112	3,115,918
Total Revenues	\$423,947,028	\$440,929,828	\$495,429,873	\$516,367,374

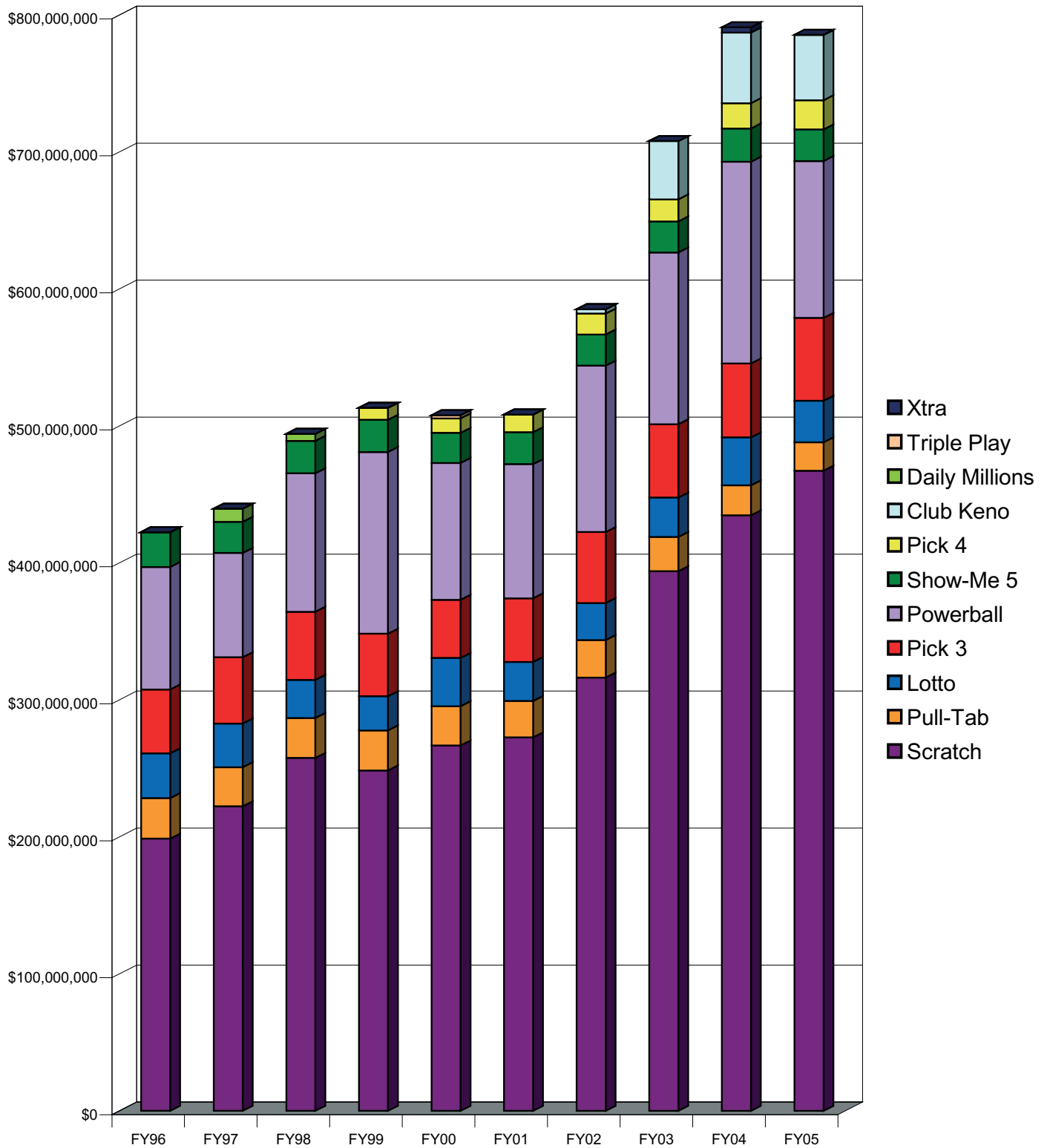
Expenses and Transfers to the State Fiscal Years 1996 through 2005

	FY96	FY97	FY98	FY99
Prizes	\$229,520,532	\$241,863,324	\$273,168,317	\$282,306,452
Retailer compensation	26,451,161	27,750,512	31,110,621	32,278,385
Ticket costs	12,556,996	10,805,208	12,457,684	13,195,977
Administration	27,360,179	27,846,857	29,167,815	30,024,072
Total Expenses	295,888,868	308,265,901	345,904,437	357,804,886
Transfers to the State	128,058,160	132,663,927	149,525,436	158,562,488
Total Expenses and Transfers	\$423,947,028	\$440,929,828	\$495,429,873	\$516,367,374

FY00	FY01	FY02	FY03	FY04	FY05
\$266,708,105	\$272,658,386	\$316,397,488	\$393,981,254	\$434,791,673	\$467,326,093
35,292,475	28,459,170	27,030,491	28,736,839	35,015,934	30,311,403
42,368,038	46,539,183	51,785,842	53,569,248	53,946,082	60,558,754
99,966,448	97,920,328	121,474,897	125,324,451	147,232,847	114,485,380
21,923,806	23,280,662	22,714,933	22,665,639	24,337,775	23,056,447
10,549,806	12,864,736	15,292,249	16,157,968	18,436,614	21,338,535
-	-	3,124,386	42,570,878	51,531,568	47,616,083
-	-	-	-	-	-
-	-	-	-	4,014,945	173,848
2,336,614	-	-	-	-	-
212,437,187	209,064,079	241,422,798	289,025,023	334,515,765	297,540,450
28,700,294	26,578,639	27,368,968	25,041,235	21,846,920	20,731,089
507,845,586	508,301,104	585,189,254	708,047,512	791,154,358	785,597,632
1,563,766	1,540,929	756,413	382,523	470,448	571,049
203,660	13,756,243	7,391,137	17,323,050	12,907,834	8,172,246
1,767,426	15,297,172	8,147,550	17,705,573	13,378,282	8,743,295
\$509,613,012	\$523,598,276	\$593,336,804	\$725,753,085	\$804,532,640	\$794,340,927

FY00	FY01	FY02	FY03	FY04	FY05
\$280,506,198	\$293,218,540	\$353,075,456	\$434,559,460	\$484,827,462	\$487,925,882
32,388,529	32,429,771	37,100,715	44,453,462	49,316,766	48,798,722
12,580,313	12,531,590	13,289,487	16,712,029	18,341,746	17,543,004
30,119,645	31,503,644	29,832,679	26,561,873	22,619,483	21,430,609
355,594,685	369,683,545	433,298,337	522,286,824	575,105,457	575,698,217
154,018,327	153,914,731	160,038,467	203,466,261	229,427,183	218,642,710
\$509,613,012	\$523,598,276	\$593,336,804	\$725,753,085	\$804,532,640	\$794,340,927

Missouri Lottery Sales By Product Fiscal Years 1996 Through 2005

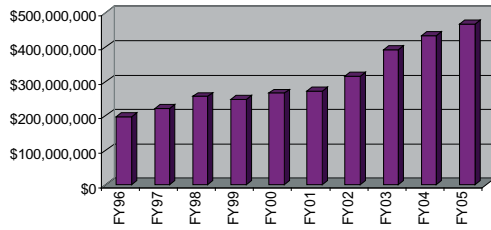


Missouri Lottery

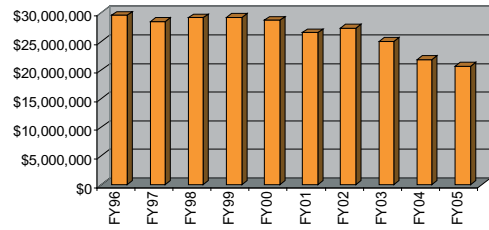
Sales By Fiscal Year By Product Line

Fiscal Years 1996 Through 2005

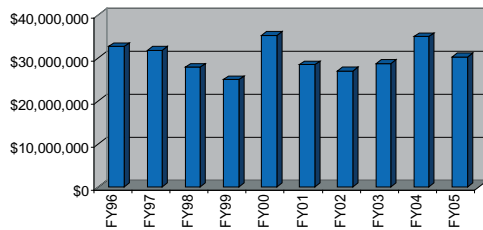
Scratchers



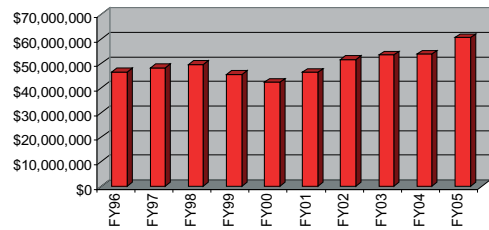
Pull-Tab



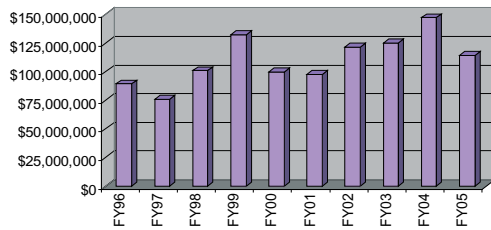
Lotto



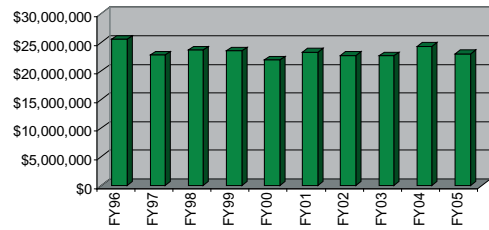
Pick 3



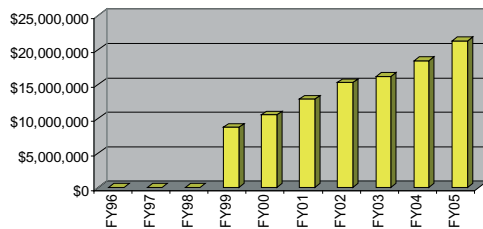
Powerball



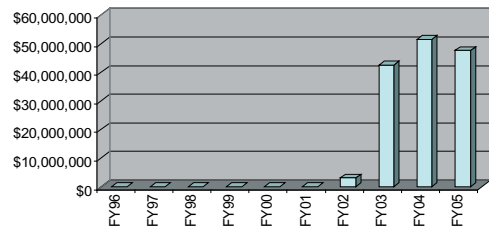
Show-Me 5



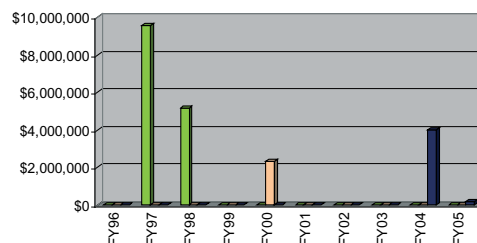
Pick 4



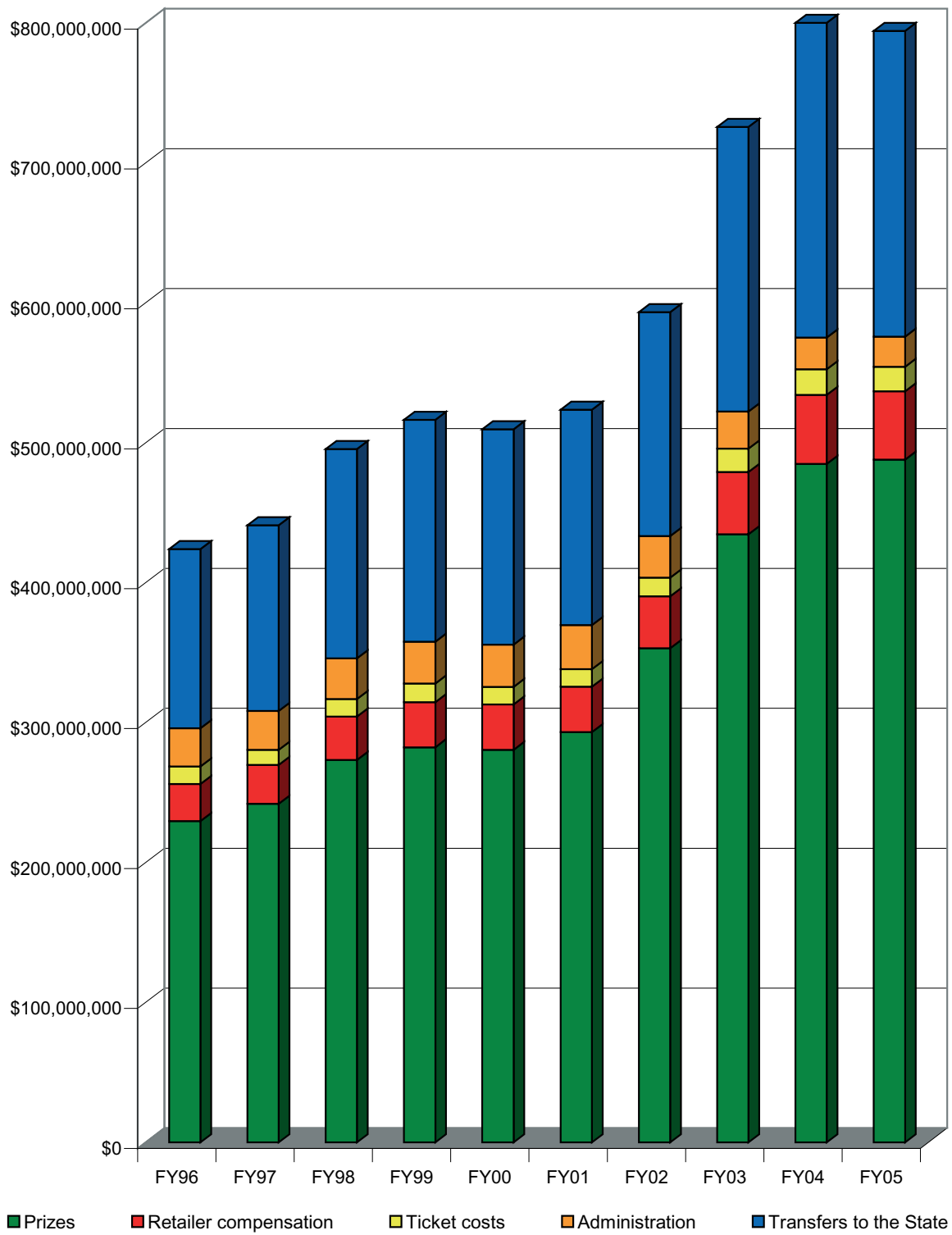
Club Keno



■ Daily Millions ■ Triple Play ■ Xtra

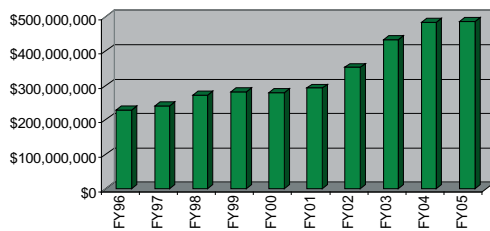


Missouri Lottery Expenses And Transfers Fiscal Years 1996 Through 2005

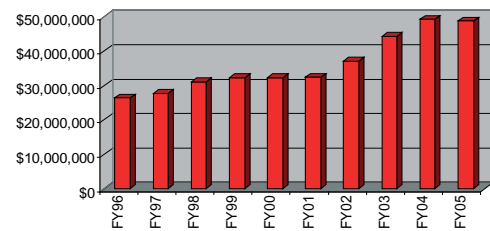


Missouri Lottery Expenses And Transfers Fiscal Years 1996 Through 2005

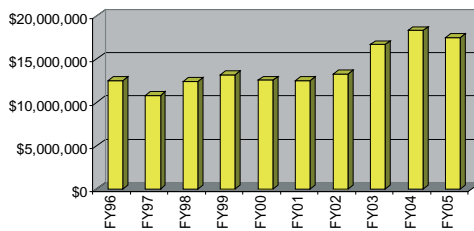
Prizes



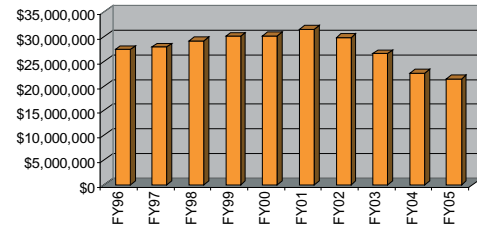
Retailer Compensation



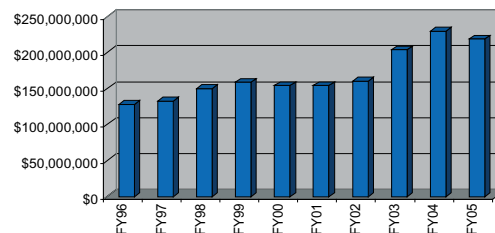
Ticket costs



Administration



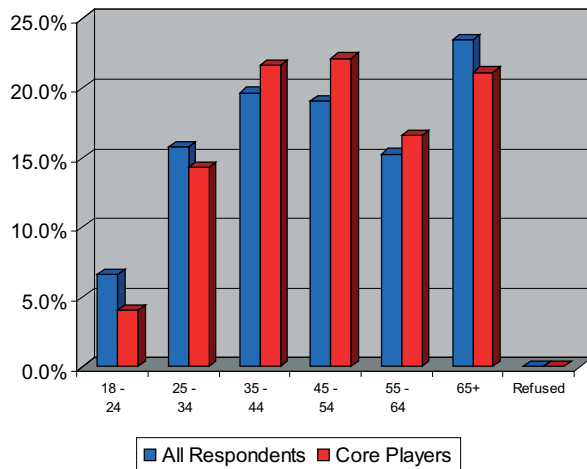
Transfers to the State



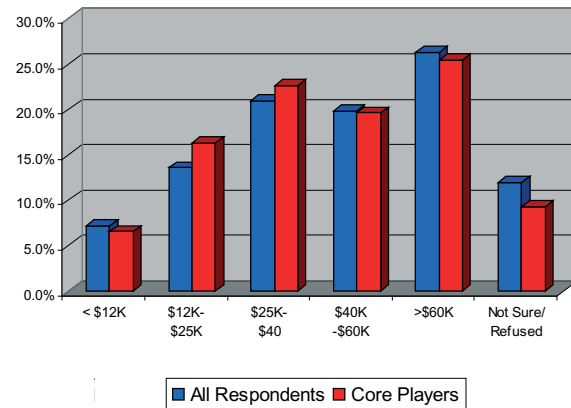
Missouri Lottery Demographic Group Participation

Source: Missouri Lottery Track and Trend Report FY2005

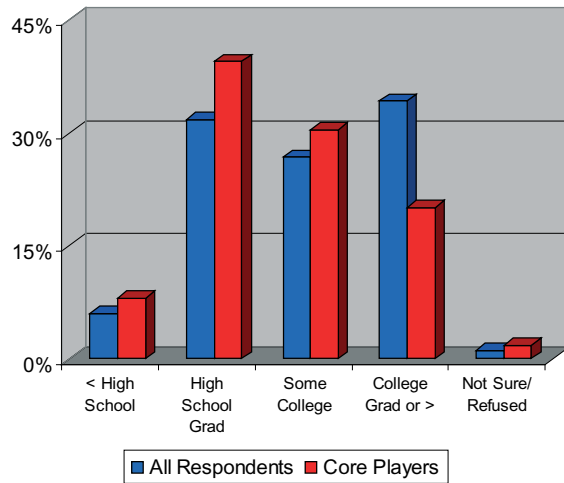
Age



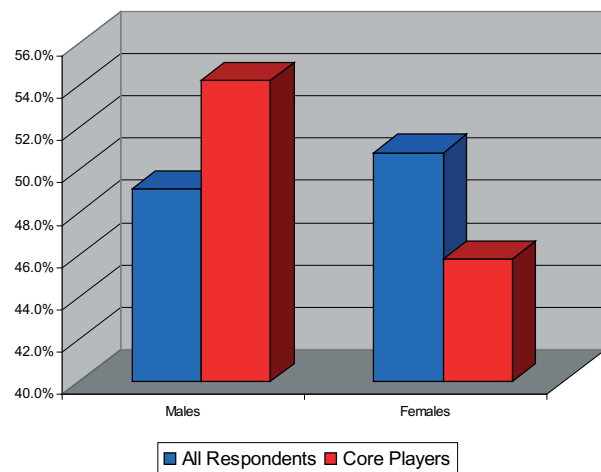
Annual Income



Education



Gender



Lotteries FY03 and FY04 Sales by Growth

Rank	Lottery Jurisdiction	Population (millions) ⁴	FY03 Sales (millions)	FY04 Sales (millions)	Growth FY04 vs. FY03	FY04 Annual Per Capita
1	South Carolina	4.2	\$724.3	\$950.0	31.2%	\$228.9
2	West Virginia (1)	1.8	\$1,081.9	\$1,303.5	20.5%	\$720.2
3	Michigan *** (5)	10.1	\$1,684.5	\$1,967.8	16.8%	\$195.2
4	Vermont	0.6	\$79.5	\$92.3	16.1%	\$148.9
5	Rhode Island (2)	1.1	\$1,290.5	\$1,480.6	14.7%	\$1,371.0
6	Nebraska	1.7	\$80.9	\$92.6	14.5%	\$53.2
7	Arizona	5.6	\$322.3	\$366.6	13.7%	\$65.7
8	Maine	1.3	\$164.6	\$185.9	12.9%	\$141.9
9	Iowa	2.9	\$187.3	\$209.9	12.1%	\$71.4
10	Missouri	5.7	\$708.6	\$791.5	11.7%	\$138.9
11	Idaho	1.4	\$98.0	\$109.3	11.6%	\$79.8
12	Virginia	7.4	\$1,135.7	\$1,262.4	11.1%	\$170.8
13	Wisconsin	5.5	\$435.1	\$482.9	11.0%	\$88.3
14	Indiana	6.2	\$664.4	\$734.9	10.6%	\$118.5
15	Pennsylvania	12.4	\$2,133.0	\$2,352.1	10.3%	\$190.1
16	Minnesota	5.1	\$351.8	\$386.9	10.0%	\$76.5
17	Louisiana	4.5	\$311.5	\$340.1	9.2%	\$75.6
18	New York *	19.2	\$5,396.0	\$5,847.5	8.4%	\$304.7
19	New Mexico	1.9	\$137.3	\$148.7	8.3%	\$79.5
20	Illinois	12.7	\$1,585.6	\$1,709.2	7.8%	\$135.1
21	Kentucky	4.1	\$673.5	\$725.3	7.7%	\$176.0
22	New Hampshire	1.3	\$221.2	\$237.1	7.2%	\$183.8
23	Florida	17.0	\$2,868.0	\$3,071.0	7.1%	\$180.4
24	District of Columbia *** (6)	0.6	\$228.9	\$245.0	7.1%	\$437.6
25	Kansas	2.7	\$210.8	\$224.2	6.3%	\$82.4
26	Montana	0.9	\$34.7	\$36.7	5.9%	\$39.9
27	California	35.5	\$2,781.6	\$2,945.9	5.9%	\$83.0
28	Maryland	5.5	\$1,322.2	\$1,395.4	5.5%	\$253.3
29	New Jersey	8.6	\$2,074.1	\$2,188.5	5.5%	\$253.3
30	Connecticut	3.5	\$865.3	\$907.7	4.9%	\$260.8
31	Oregon (1)	3.6	\$853.4	\$893.3	4.7%	\$250.9
32	Washington	6.1	\$460.3	\$481.4	4.6%	\$78.5
33	Massachusetts	6.4	\$4,197.8	\$4,381.3	4.4%	\$681.4
34	Georgia	8.7	\$2,604.4	\$2,710.5	4.1%	\$312.3
35	Ohio	11.4	\$2,078.3	\$2,154.7	3.7%	\$188.4
36	South Dakota (2)	0.8	\$647.0	\$664.4	2.7%	\$874.2
37	Colorado	4.6	\$391.5	\$401.3	2.5%	\$88.2
38	Puerto Rico	3.9	\$337.0	\$344.0	2.1%	\$88.7
39	Delaware (1)	0.8	\$628.1	\$640.9	2.0%	\$781.6
40	Texas **	22.1	\$3,130.7	\$2,904.9	-7.2%	\$131.3
41	North Dakota (8)	0.6		\$5.8		\$9.3
42	Tennessee (7)	5.8		\$427.7		\$73.2
TOTAL U.S. (\$US)		259.2	\$42,421.7	\$45,290.6	6.8%	\$174.7

Notes: Results are unofficial and unaudited

* FY ends 3/31

** FY end 8/31

*** FY end 9/30

**** FY ends 12/31

(1) Includes net VLT sales (Cash in less cash out)

(2) Includes gross VLT sales (Cash in)

(3) Does not include Casino sales or profits

(4) Source - US Data: US Census Bureau estimated July 1, 2003 population

(5) Sales estimated through 9/30/04

(6) Sales/Profits reported for July 1, 2003 to June 30, 2004

(7) Sales began January 20, 2004

(8) Sales began March 25, 2004

Lotteries ranked by FY 2004 Per Capita Sales

Rank	Lottery Jurisdiction	Population (millions) ⁴	FY04 Sales (millions)	FY04 Annual Per Capita
1	Rhode Island (2)	1.1	\$1,480.6	\$1,371.0
2	South Dakota (2)	0.8	\$664.4	\$874.2
3	Delaware (1)	0.8	\$640.9	\$781.6
4	West Virginia (1)	1.8	\$1,303.5	\$720.2
5	Massachusetts	6.4	\$4,381.3	\$681.4
6	District of Columbia *** (6)	0.6	\$245.0	\$437.6
7	Georgia	8.7	\$2,710.5	\$312.3
8	New York *	19.2	\$5,847.5	\$304.7
9	Connecticut	3.5	\$907.7	\$260.8
10	New Jersey	8.6	\$2,188.5	\$253.3
11	Maryland	5.5	\$1,395.4	\$253.3
12	Oregon (1)	3.6	\$893.3	\$250.9
13	South Carolina	4.2	\$950.0	\$228.9
14	Michigan *** (5)	10.1	\$1,967.8	\$195.2
15	Pennsylvania	12.4	\$2,352.1	\$190.1
16	Ohio	11.4	\$2,154.7	\$188.4
17	New Hampshire	1.3	\$237.1	\$183.8
18	Florida	17.0	\$3,071.0	\$180.4
19	Kentucky	4.1	\$725.3	\$176.0
20	Virginia	7.4	\$1,262.4	\$170.8
21	Vermont	0.6	\$92.3	\$148.9
22	Maine	1.3	\$185.9	\$141.9
23	Missouri	5.7	\$791.5	\$138.9
24	Illinois	12.7	\$1,709.2	\$135.1
25	Texas **	22.1	\$2,904.9	\$131.3
26	Indiana	6.2	\$734.9	\$118.5
27	Puerto Rico	3.9	\$344.0	\$88.7
28	Wisconsin	5.5	\$482.9	\$88.3
29	Colorado	4.6	\$401.3	\$88.2
30	California	35.5	\$2,945.9	\$83.0
31	Kansas	2.7	\$224.2	\$82.4
32	Idaho	1.4	\$109.3	\$79.8
33	New Mexico	1.9	\$148.7	\$79.5
34	Washington	6.1	\$481.4	\$78.5
35	Minnesota	5.1	\$386.9	\$76.5
36	Louisiana	4.5	\$340.1	\$75.6
37	Tennessee (7)	5.8	\$427.7	\$73.2
38	Iowa	2.9	\$209.9	\$71.4
39	Arizona	5.6	\$366.6	\$65.7
40	Nebraska	1.7	\$92.6	\$53.2
41	Montana	0.9	\$36.7	\$39.9
42	North Dakota (8)	0.6	\$5.8	\$9.3
TOTAL U.S. (\$US)		259.2	\$45,290.6	\$174.7

Notes: Results are unofficial and unaudited

* FY ends 3/31

** FY end 8/31

*** FY end 9/30

**** FY ends 12/31

(1) Includes net VLT sales (Cash in less cash out)

(2) Includes gross VLT sales (Cash in)

(3) Does not include Casino sales or profits

(4) Source - US Data: US Census Bureau estimated July 1, 2003 population

(5) Sales estimated through 9/30/04

(6) Sales/Profits reported for July 1, 2003 to June 30, 2004

(7) Sales began January 20, 2004

(8) Sales began March 25, 2004

Supplementary Information





Berberich Trahan & Co., P.A.
Certified Public Accountants
Topeka, Kansas 66611-2050



COCHRAN, HEAD & CO., P.C.
Certified Public Accountants
Liberty, Missouri 64068

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

To the Missouri State Lottery Commission:

We have audited the basic financial statements of the Missouri State Lottery Commission as of and for the years ended June 30, 2005 and 2004, and have issued our report thereon dated October 6, 2005 and September 24, 2004, respectively. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Missouri State Lottery Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected with in a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Missouri State Lottery Commission's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of management and the Missouri State Lottery Commission and is not intended to be and should not be used by anyone other than these specified parties.

Berberich Trahan & Co., P.A.

Cochran, Head & Co., P.C.

October 6, 2005

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